NOS. 75-1289, ET AL.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO. 75-1304

AMERICAN PUBLIC GAS ASSOCIATION, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

NO. 75-1305

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

NO. 75-1308

ASSOCIATED GAS DISTRIBUTORS, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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April 12, 1976
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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

Shell Oil Company, *et al.*[1], herein called "Producers", parties to the case below and Respondents in Case Nos. 75-1304, 75-1305, and 75-1308[2], hereby submitted their

1. A complete list of the Producer Respondents joining herein is contained on the inside cover of this Brief.

2. Some of the parties joining herein are also Petitioners in Case No. 75-1299. Parties hereto take no position as to whether the Petition in Case No. 75-1289 should be granted.

Brief in Opposition to the Petitions filed in Case Nos. 75-1304, 75-1305, and 75-1308, for Writs of Certiorari to review the Opinion and Judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on October 14, 1975.

STATEMENT OF POSITION

The principal question raised by Petitioners in Case Nos. 75-1304, 75-1305, and 75-1308, is whether the Commission is required by the Natural Gas Act or previous decisions of this Court to adhere to the "two-price" or "multiple vintage price" approach to producer pricing which it had adopted in the earlier area rate decisions[3], or whether it has discretion to find that this approach has failed to elicit adequate gas supplies, and should be gradually phased out.

The "phase-out" procedure, in which the Commission permits "old" gas to become "new" with reference to the ceiling price to be applied to the gas, when the initial long-term contract under which the gas was sold has expired by its terms[4], and the producer and pipeline purchaser have entered into a new contract "rededicating" the gas to the interstate market, was initially announced by the Commission in the *Appalachian Area Rate Decision,* 48 F.P.C. 1299 (1972). It was strongly attacked on appeal by the Public Service Commission of New York,

3. *Permian Basin Area Rate Decision,* 34 F.P.C. 159, reversed, *Skelly Oil Co. v. F.P.C.,* 375 F.2d 6 (10th Cir. 1967), reversed and Commission affirmed, *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968); *Southern Louisiana Area Rate Case II,* 46 F.P.C. 86; affirmed, *Placid Oil Co. v. F.P.C.,* 483 F.2d 880 (5th Cir. 1973); affirmed, *Mobil Oil Corp. v. F.P.C.,* 417 U.S. 283 (1974).

4. Acceleration of the expiration date initially provided in the contract is not permitted under the Commission orders.

Petitioner in Case No. 75-1305, and the Associated Gas Distributors, Petitioner in Case No. 75-1308. After hearing the same arguments raised here, the United States Court of Appeals for the Fifth Circuit affirmed the Commission in *Shell Oil Company v. F.P.C.,* 491 F.2d 82 (1974).

The Commission continued its new policy in its *Rocky Mountain Area Rate Decision,* 49 F.P.C. 924, 49 F.P.C. 1279 (1973), and in its second *Permian Basin Area Rate Decision,* 50 F.P.C. 390, 50 F.P.C. 932 (1973), appealed to the United States Court of Appeals for the Ninth Circuit, *Public Service Commission of the State of New York v. F.P.C.,* Case No. 73-3328, petition withdrawn. New York and AGD continued their challenge to the Commission's new policy, appealing various orders implementing this policy in other areas. These appeals were taken to the United States Court of Appeals for the District of Columbia Circuit, which also upheld the Commission in *Public Service Commission of New York v. F.P.C.,* ____ F.2d ____ (Case Nos. 75-1647, *et al.*, D.C. Circuit, issued January 27, 1976).

In the case below, the Commission had before it substantial evidence of the massive capital requirements of the producing industry, if that industry is to accomplish even the minimum objective of replacing natural gas supplies being currently produced. Even if the National Ceiling Rate For New Gas were high enough to constitute the necessary incentive for investment, which Producers dispute[5], it would be many years before enough gas

5. The reasons why the National Ceiling Rate is inadequate as an incentive are succinctly summarized in Commissioner Moody's dissent to Opinion No. 699, C.A. C-220-C-227.

could be found and dedicated to substantially increase the industry's revenues, and provide needed capital.[6]

The principal source of *current* capital for gas exploration must be revenues from the sale of gas already found and in production. This method of satisfying this need for capital availability is relied upon by the Commission at various places in its opinion (C.A. D-34, 35; C.A. D-54, 55, C.A. D-75) in support of its adoption of a minimal rate of return (C.A. D-34, 35; C.A. D-75), and its refusal to give effect to other "non-cost" factors. This evidence was also relied on by the Court of Appeals in affirming the Commission on this issue (C.A. A-29).

In addition to the need for generation of capital to perform gas exploration, the Commission also had before it evidence that as a gas reservoir nears depletion, as is usually the case after the expiration of a long-term (usually 20 years) contract, additional expenditures for compression, well workovers, etc. are required to continue the gas on production. If the price is adequate, these expenditures will be made. If it is not, the wells will be abandoned and the remaining reserves lost. From the standpoint of the cost to the consumer, even allowing for an increase in the price paid the producer, this gas is less expensive than newly discovered gas supplies, be-

6. The impact of the phase-out procedure was estimated in the dissenting opinion of Commissioner Smith at 2.6 billion dollars, a figure cited in all three Petitions. This is a gross overstatement. As New York admits (p. 14), the impact has already been reduced by an increase in the ceiling price allowed all "flowing" gas in Docket No. R-478 by one-third. Commissioner Smith also failed to consider the fact that new contracts will not be immediately signed by the pipelines, delaying the application of the new ceiling. New wells drilled on renegotiated contracts would receive the new rate in any event further reducing the impact of this procedure. The overall impact of the entire rate structure was considered by the Commission (C.A. D-56 to D-62). This is all that is required.

cause all of the pipeline facilities needed to connect the gas are already in place and must be included in the pipeline rate base, whether they are used or not.

New York (p. 17) and APGA (p. 15) insist that the premature abandonment problem be handled on an individual case-by-case basis through applications for "special relief" from the ceiling rates to the Commission, in which the producer would be required to prove that the gas could not be continued in production under the ceiling for "old" gas before a higher rate was allowed. Like the individual company cost-based rate approach condemned in *Permian*[7], an individual case-by-case approach to this problem is doomed to failure by the administrative burden and lengthy delays occasioned by the procedure.[8]

We therefore believe, as did the Court of Appeals (C.A. A-31), that the Commission had substantial evidence in the record, and sufficient discretion and authority under the Act and decisions of this Court and those of various Courts of Appeals, to modify and "phase out" the multiple vintage price system.

APGA raised two additional questions, one of which has already been resolved by the courts adversely to their position, and the other of which amounts to a choice of various alternative costing methods which is clearly within the Commission's discretion.[9] We will briefly discuss why

7. *Permian Basin Area Rate Cases*, 390 U.S. 747, 757.

8. It is also noteworthy that in the few cases where this approach has been attempted, it has been reversed by the Courts, see *Macdonald v. F.P.C.*, 505 F.2d 335 (D.C. Cir. 1974); *Cities of Fulton, et al. v. F.P.C.*, 512 F.2d 947 (D.C. Cir. 1975).

9. The questions raised as to the amount of liquid credit and the credibility of the reserves estimate are clearly matters within the Commission's discretion and do not require review here.

these questions also do not warrant this Court's consideration.

REASONS FOR DENYING THE PETITIONS FOR WRITS IN CASE NOS. 75-1304, 75-1305, AND 75-1308

I. The Questions Raised By These Petitions Do Not Fall Within The Standards Of Review Laid Down By This Court.

In *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283 (1974), this Court reiterated and amplified the standards of review of Federal Power Commission Orders laid down in *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747, at 767 (1968). The Commission was given broad discretion to select modes of regulation, which would not be overturned by the courts unless they lacked support by substantial evidence, or unless the Commission had exceeded or abused its authority. Here the Commission has made a determination, repeated in three area rate decisions, innumerable specific orders, and the major national rate decision here under review, that the two-price system initially adopted as an experiment in *Permian* was theoretically unsound (C.A. D-54, 55) and has dramatically failed to produce adequate supplies of natural gas for the consumers of this nation (C.A. C-19 to C-29). The Commission therefore decided to gradually eliminate the multiple vintage price system by allowing gas in the latter stage of the depletion process (the time when additional expenditures may expand reserves by deferring the abandonment date) to be priced at the ceiling rate for "new" gas. Over a period of years the "vintaging" of gas

prices will gradually disappear (Court of Appeals opinion, C.A. A-31), thus minimizing the impact on the consumer. This type of policy decision is discretionary with the Commission; thus, under *Mobil, supra* (417 U.S. 283, 308), the Court should not "supplant" the Commission's decision. *Mobil* further teaches that the review of the Commission's decision is the primary function of the Court of Appeals, and

> "'. . . This Court will intervene only in what ought to be the rare instance where the standard appears to be misapprehended or grossly misapplied.' Universal Camera Corp. v. NLRB, 340 U.S. 474, 491." (417 U.S. 283, 310)

The Court of Appeals thoroughly reviewed the Commission's action utilizing the *Mobil* standards (C.A. A-28 to A-31). No further action is required by this Court.

II. The Commission's Decision To Abolish Vintaging Is Soundly Based, Both In Theory And In Substantial Record Evidence.

A. The Two-Price System Has Failed.

The Commission's Opinion below points out at length the developing shortage of natural gas in the United States, and the manifest failure of the *Permian* method of regulation to cope with the growing shortage (C.A. C-19 to C-43). The basic reason for the failure, discussed in depth in the concurring and dissenting opinion of Commissioner Moody (C.A. C-169 to C-229), is that in a period of inflation and increasing costs, holding the bulk of the nation's gas supply to rates which are based upon the estimated *original* cost of developing these reserves

will not provide the capital required to replace those reserves with new supplies. It is the view of the Producers that the Commission has failed to recognize that its cost-based rate is too low, both in the manner of its calculation, and as judged by external market tests. In so doing, it has created a ceiling rate which is much too low to provide even future incentives to resolve the gas shortage. This is tacitly admitted by Petitioners, who urge that the producers will not recommit the capital obtained by the abolition of the vintaging policy to further gas exploration unless the funds are earmarked, and their use policed, by the Commission (New York, p. 17; AGD, p. 9; APGA, p. 15). If the Commission's ceiling price is what it is statutorily required to be, and will provide a return sufficient to attract investment (*Permian*, 390 U.S. 747, 796), then such earmarking and policing are not required.

The Commission has treated the inclusion of a portion of the gas already flowing in the "new" gas vintage ceiling as a "non-cost" factor to provide additional capital to the industry which cannot be provided by the ceiling price for future gas, no matter what the level of that price may be. In addition, it has imposed the serious requirement that the purchasing pipeline company must sign a new contract before the new vintage price will apply. As The Superior Oil Company pointed out to the Court of Appeals, the pipeline is in a vastly superior bargaining position, as the gas must continue to be sold to it unless and until the Commission permits abandonment (see *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137 (1959). The producer must provide some new consideration to the pipeline before the pipeline will renegotiate the contract, where the only effect of the renegotiation is to permit the application of a higher ceiling price. Contrary to the allegations of Petitioners, the pipelines *have* required further consideration, such as, commitment of additional new reserves, further exploration or development expenditures, before entering into "renegotiated" contracts.

In *Mobil, supra,* this Court specifically approved the new Commission policy of placing part of the burden of expanding gas exploration on all users of natural gas, rather than on those alone who purchase gas in the future (417 U.S. 283, 320). The current Commission decision represents a permissible expansion of this policy.

B. The Two-Price System Has Always Been Theoretically Unsound And Discriminatory.

Although this Court in *Permian* approved the use of the two-price system on an "experimental" basis, it did so as a proper use of the Commission's discretion, not on any mandatory basis, see *Permian,* 390 U.S. 747, 797-98.

The theory of the two-price system was sharply criticized by the Court of Appeals for the Fifth Circuit in *Placid Oil Co. v. F.P.C.*, 483 F.2d 880, 899-900 (1973). That Court discussed the logical inconsistency of arbitrarily distinguishing an indistinguishable commodity by date of contract (see 488 F.2d at 890). This Court approved the Fifth Circuit's reasoning in *Placid* in its *Mobil* decision, *supra,* specifically rejecting arguments made by New York, one of the Petitioners here (No. 75-1305) that the entire burden of the cost of finding new gas supplies must be placed on the consumers of those supplies, and not on existing users, see 417 U.S. at 320.

The Commission has already substantially departed from the *Permian* two-price system prior to this case. In

Opinion No. 567, 42 F.P.C. 727 (1969), the Commission provided that new reservoirs discovered under "old" vintage contracts should receive the "new" vintage price where the date of discovery of the reservoir was "new" vintage. In another part of the Opinion below (C.A. C-154, C-155), the Commission included under the "new" gas ceiling price wells commenced on previously contracted acreage, where the well was commenced in the "new" vintage time period. This part of the Opinion is not challenged by Petitioners. Yet these are similar efforts by the Commission to phase out the "anachronistic" (*Appalachian Area Rate Decision,* 48 F.P.C. 1299, 1309, affirmed, *Shell Oil Co. v. F.P.C.,* 491 F.2d 32 (5th Cir. 1974)) multiple vintage price system.

III. The Other Questions Raised By The American Public Gas Association Do Not Merit Consideration By This Court.

A. The Commission's Power To Establish Rates By Rulemaking Has Been Affirmed By Three Circuit Courts of Appeals, Following *United States v. Florida East Coast Railway.*[10]

The American Public Gas Association's attack on the power of the Commission has been unanimously rejected in all of the courts where it has been raised, and the courts have held that the formal hearing processes of the Administrative Procedure Act are not required, see *Phillips Petroleum Co. v. F.P.C.,* 475 F.2d 842 (10th Cir. 1973), *cert. denied, sub nom. Chevron Oil Co. v. F.P.C.,* 414 U.S. 1146 (1974); *American Public Gas Association v. F.P.C.,* 498 F.2d 718 (D.C. Cir. 1974); *United States v. Florida East Coast Ry.,* 410 U.S. 224, 246 (1973).

10. 410 U.S. 224 (1973).

Far from being contrary to the decision of the Court of Appeals below, as alleged by APGA (p. 8), the decision of the District of Columbia Circuit in *Mobil Oil Corp. v. F.P.C.,* 483 F.2d 1238 (1973) is completely consistent with the Commission's actions here and the decision below of the Fifth Circuit. The D. C. Circuit *declined* to hold that the Commission was required to follow the procedures set out in Sections 556 and 557 of the Administrative Procedure Act (see 483 F.2d at 1250, 1253-54). The D.C. Circuit required only that each party be given ample opportunity to criticize and attack contrary positions taken by other parties (see 483 F.2d at 1258). This the Commission did in the proceedings below (C.A. C-14 to C-18, D-6, 7).

The Court of Appeals below thoroughly considered APGA's arguments and found that all procedural requirements of the Natural Gas Act and Administrative Procedure Act had been satisfied (C.A. A-23 to A-27). No review is required by this Court.

B. The Commission Has Discretion To Adopt The DCF Costing Method On Rehearing.

APGA is the only Petitioner contending that the Commission's adoption of the discounted cash flow ("DCF") costing methodology is not within the Commission's discretion. APGA's argument is without merit for three reasons.

First, substantial record evidence warranted adoption of DCF costing methodology. Dr. Ezra Solomon presented

extensive testimony demonstrating that this is the only methodology the Commission could use to accurately state anticipated rate of return on capital investment since this is the only methodology which takes into account receipts on investment relative to time of outlay, that is, the time value of money. Mr. Robert H. Park submitted testimony illustrating an actual DCF format.

Second, in approving the Commission's choice of the DCF methodology, the Court pointedly stated that:

> "Without delving into the complexities of an esoteric costing methodology which counsel could scarcely describe in their briefs or at oral argument, we need only note that a reviewing court would go far afield in striking down an analytical model adopted by the Commission." (C.A. A-36)

The selection between the various types of costing methodology lies within the Commission's discretion, see *Permian* (390 U.S. 747, 776-77).

Third, the Court of Appeals correctly ruled that Petitioners in the case below failed to demonstrate that use of DCF methodology produced an unjust and unreasonable end result.

No new arguments against use of DCF methodology have been raised in Petitions to this Court. The Court of Appeals correctly decided that no grounds exist for striking down the DCF methodology employed by the Commission in this proceeding.

CONCLUSION

None of the questions raised in Case Nos. 75-1304, 75-1305, and 75-1308 invoke review by this Court under the standards of *Mobil*. The gradual elimination of the

"vintage" price system, an experiment which was theoretically wrong and has manifestly failed, is long overdue. These Petitions for Certiorari should be denied.

Respectfully submitted,

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